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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant,

v.

G. D. BAIR, DIRECTOR OF REVENUE, STATE OF IOWA,
Appellee.

On Appeal from the Supreme Court of the State of Iowa

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT

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QUESTION PRESENTED

Whether net income tax on corporations imposed by the Code of Iowa, which attributes to Iowa 100% of the income from the sale of goods manufactured without Iowa, but sold within Iowa, so discriminates against interstate commerce as to violate the Commerce Clause and so unfairly apportions the income derived from such activity as to offend due process.

INTEREST OF THE AMICUS

The Committee on State Taxation of the Council of State Chambers of Commerce (COST) consists of over 100 companies which have multi-state operations and derive income from multi-state sources. The members of COST have a vital interest in the uniform apportionment of income among the states and in the prevention of multiple state taxation. COST has long been involved in the study of interstate business transactions and both COST and its members have accumulated a great deal of expertise with respect to interstate taxation. Accordingly, COST believes that it can make a significant contribution to the Court's consideration of this case.

ARGUMENT

1. Iowa imposes an income tax on corporations whose business is carried on partly within and partly without the state. Where a corporation's income is derived from the manufacture or sale of goods both within and without the state, Iowa employs a single "sales-factor formula" under which the corporation's apportionable net income [1] is attributed to Iowa "in that proportion which the gross sales made within the state bear to the total gross sales." Section 422.33(1)(b), Code of Iowa.[2]

Iowa is the only state requiring the division of income on the basis of a single "sales-factor formula" (J.S. App. A, p. A5; J.S. App. B, p. A37). Forty-four [3] of the forty-

[1] Certain income of the corporation, such as interest, dividends, rents, and royalties, is wholly attributed to the state of its geographic source. Section 422.33(1)(a), Code of Iowa. The remainder of the corporation's net income is apportioned.

[2] Sales are attributed to the state of destination, not of origin. Section 422.33(1)(b), Code of Iowa.

[3] Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii,

five other states (including the District of Columbia) which impose a corporate income tax utilize a three-factor apportionment formula which takes into account the geographical distribution of a corporation's payroll, property and sales.[4]

Iowa's single sales-factor apportionment formula fails to meet the constitutional test of reasonableness. *See, e.g., General Motors Corp.* v. *District of Columbia*, 380 U.S. 553, 560; *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-121; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271, 283; *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 132. Specifically, it violates the Commerce Clause of the Constitution, Art. 1, § 8, cl. 3, and the Due Process Clause of the Fourteenth Amendment. Iowa's formula violates the Commerce Clause because it leads ineluctably to multiple taxation of foreign corporations doing business in Iowa, and because it inevitably discriminates against interstate commerce by affording local manufacturers a competitive advantage over their foreign rivals. It offends due process by arrogating corporate income to the state out of all proportion to the business activities within the state.

The constitutionality of a single sales-factor formula was discussed in *General Motors Corp.* v. *District of Columbia, supra*, 380 U.S. 553, in which the Court considered such a formula and found it unauthorized by the statute, which allowed taxation of net income "fairly

Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, and Wisconsin.

[4] Colorado also has a two-factor property and sales formula, and Missouri a one-factor sales formula, which are available to taxpayers at their option as alternatives to the three-factor formula. The forty-fifth state, West Virginia, uses a two-factor formula which omits the sales component of the traditional three-factor formula.

attributable" to business activities within the District of Columbia. The Court undertook to review the Court of Appeals' approval of the District's single sales-factor formula because such approval "lends sanction to an apportionment formula seriously at variance with those prevailing in the vast majority of States and creates substantial dangers of multiple taxation" (380 U.S. at 556-557). While not deciding the constitutional question, the Court noted that the reasonableness standard as it had been articulated in the earlier cases lent "little support to the use of an exclusively sales-oriented approach." [5] Noting that an income apportionment formula should approximate "the distribution of either a corporation's sources of income or the social costs which it generates," the Court concluded that "the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor" (380 U.S. at 561).[6]

2. Iowa does not challenge the governing principles relied upon by Moorman. Indeed, Iowa does not even attempt to defend the reasonableness of its apportionment formula. Rather, it attacks Moorman's factual case (Motion to Dismiss, pp. 6-7, 10, 13-14), and accuses Moorman of trying to impose upon it a specific three-factor formula, contrary to the accepted principle that "[t]he Constitution is not formulary" (*Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 550). Motion to Dismiss, pp. 7-8, 9.

The latter contention is simply a misstatement. Moorman seeks only to have Iowa's present single sales-factor formula declared unconstitutional (J.S., pp. 4-5,

[5] For a discussion of the constitutional implications of *General Motors*, *see*, Hellerstein, *State Tax Discrimination Against Out-of-Staters*, 30 Nat'l Tax J. 113, 122 (1977).

[6] For a criticism of the sales factor on economic grounds, *see*, Studenski, *The Need For Federal Curbs On State Taxes On Interstate Commerce: An Economist's Viewpoint*, 46 Va. L. Rev. 1121, 1131-33, 1147 (1960); Hartiss, *Economic Aspects Of Interstate Apportionment Of Business Income*, 37 Taxes 327, 362-63 (1959).

"Questions Presented"). Far from having a three-factor formula forced upon it, Iowa has stipulated to such a formula as the basis on which Moorman's Iowa income will be computed if the single sales-factor formula is invalidated. App. 31. Moreover, Moorman amply demonstrated multiple taxation, discrimination against out-of-state businesses and unfair apportionment of income.

3. *Multiple Taxation.* While a state may impose a net income tax on the portion of a foreign corporation's net income earned from, and fairly apportioned to, the taxing state (*Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450), it is equally settled that a state may not "impose a tax which discriminates against interstate commerce * * * by subjecting interstate commerce to the burden of 'multiple taxation' * * *." *Id.* at 458; *see also Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 47 U.S. 157; *J.D. Adams Manufacturing Co.* v. *Storen*, 304 U.S. 307. Iowa does not dispute that an apportionment formula which causes multiple taxation of enterprises engaged in interstate commerce violates the Commerce Clause. Rather, Iowa claims that Moorman's evidence regarding double taxation is inadequate because it is based on the allegedly invalid assumption that Iowa taxed 100% of Moorman's income from Iowa sales and on a comparison of the Illinois and Iowa apportionment formulae "in the abstract," which does not consider Moorman's income-producing activities in all states. Motion to Dismiss, pp. 13-15.

Iowa's argument that it did not tax Moorman on 100% of its income from Iowa sales is based on the availability of deductions from gross income in arriving at Iowa net income. This argument would have weight only if the issue were whether Iowa taxed Moorman on 100% of its *gross* income; however, there is no question that the Iowa corporate income tax in question is a *net* income tax. Iowa does not dispute the fact that, once Moorman's

net income from Iowa sales is determined, Iowa's single sales-factor formula assigns 100% of that income to Iowa.

Indeed, a single sales-factor apportionment formula reaches, and is intended to reach, the entire net income connected with sales in the taxing state, even when capital and labor in other jurisdictions have contributed to the earning of such income. This Court recognized in *General Motors* that a single sales-factor apportionment formula results in the attribution of 100% of the income in question to the jurisdiction having such a formula. *General Motors, supra*, 380 U.S. at 557, 560.

A single sales factor apportionment formula, in the context of the general use of three-factor apportionment formulae which take into account the location of a corporation's property and payroll as well as sales (*see supra* p. 3), necessarily results in multiple taxation, because "the States in which the property and payroll of the corporation are located will allocate to themselves 67% of the corporation's income, whereas the jurisdictions in which the sales are made will allocate 100% of the income to themselves." *General Motors, supra*, 380 U.S. at 560. Indeed, Iowa itself has admitted that its single sales factor formula results in double taxation. J.S. App. A, p. A6.

Moorman's evidence of the double taxation of its income from Iowa sales presents concrete proof of the double taxation which this Court found in *General Motors* is inherent in a single sales factor apportionment formula. *General Motors, supra*, 380 U.S. at 560. Moorman limited its evidence to Iowa and Illinois because all of Moorman's products sold in Iowa were manufactured in Illinois. App. 24. Having proven conclusively that the interplay of the Iowa and Illinois apportionment formulae would result in the taxation of 141.76% of its 1968 income from Iowa

sales, Moorman had no reason to present evidence regarding the taxation of its other income in states that had no connection with the income producing activities which resulted in the Iowa sales.

4. *Discrimination Against Out-of-State Businesses.* The granting of competitive advantages to local enterprises, which are withheld from foreign corporations, also violates the Commerce Clause. In *Northwestern States Portland Cement Co.* v. *Minnesota, supra*, 358 U.S. at 458, this Court observed that a state may not "impose a tax which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business, *Memphis Steam Laundry* v. *Stone*, 342 U.S. 389 (1952); *Nippert* v. *Richmond*, 327 U.S. 416 (1946) * * *." Again, Iowa does not claim that an apportionment formula which favors local business is permissible under the Commerce Clause; rather it asserts that Moorman's proof on this question consists of " 'hypothetical cases * * * imagined' ", (quoting *United States* v. *Raines*, 362 U.S. 17, 22) and thus that no showing has been made that its formula "subsidizes exports and imposes a tariff on imports." Motion to Dismiss, pp. 6-7, 10, 13.

To the contrary, Moorman has demonstrated that the necessary result of the single sales-factor apportionment formula is to favor Iowa manufacturers which sell their products in Iowa. This is not the "imagined" possibility that the Court disapproved in *Raines;* it is a real advantage to actual enterprises based in the taxing state. The district court observed this precise effect of Iowa's single sales-factor formula (J.S. App. A, p. A38).

> While Moorman's business in Iowa is subjected to the double tax of both Iowa and Illinois, a similarly situated Iowa interstate manufacturer shipping goods, for example, to Illinois would pay taxes only

in Illinois; then on the one-third portion of its business activity there represented by its Illinois sales.

The Court in *General Motors*, *supra*, 380 U.S. at 560, accepted the validity of this type of proof by noting that, while businesses which manufacture in a three-factor jurisdiction and sell in a single sales factor jurisdiction will be subjected to double taxation, "in some cases enterprises will have their payroll and plant located in the sales-factor jurisdictions and make their sales in the three-factor jurisdictions so that only 33% of their incomes will be subject to state taxation."

Iowa's single sales-factor formula affords this commercial advantage to Iowa-based manufacturers, not only in relation to Illinois-based competitors, but over all interstate businesses making sales in Iowa whose plants and payroll are located in any of the forty-five other states that impose a corporate income tax, because all of the other forty-five states utilize property and payroll in their apportionment formulae.[7] *See*, *supra*, p. 3.

5. *Unfair Apportionment of Income.* A state may impose a tax on a foreign corporation doing business within the state, "if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *Wisconsin* v. *J. C. Penney Co.*, 311 U.S. 435, 444. That requirement is satisfied "if the tax is fairly apportioned to the commerce carried on within the State." *Ott* v. *Mississippi Valley Barge Line Co.*, 336 U.S.

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[7] This advantage would exist to a lesser extent over such interstate businesses operating in both Iowa and Colorado which elect to use Colorado's alternative two-factor property and sales apportionment formula. The advantage would not exist over inter-state businesses operating in both Iowa and Missouri which elect to use Missouri's alternative single sales-factor apportionment formula. See *supra* p. 3 n. 4.

169, 174; *Northwestern States Portland Cement Co.* v. *Minnesota*, *supra*, 358 U.S. at 452.

For this reason, the Court held in *Norfolk & Western Railway Co.* v. *Missouri State Tax Commission*, 390 U.S. 317, 325, n. 5:

> A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to "project the taxing power of the state plainly beyond its borders." *Nashville, C. & St. L.R. Co.* v. *Browning*, 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing state. *Fargo* v. *Hart*, 193 U.S. 490, 499-500 (1904) [footnote omitted].

As before, Iowa does not challenge the validity of the constitutional principle that an apportionment formula which taxes income out of all reasonable proportion to the corporation's business activities within the state violates due process. Rather, Iowa claims that an inadequate evidentiary showing of unreasonably disproportionate taxation of income has been made. Motion to Dismiss, p. 13. However, the district court found on the basis of stipulated facts (J.S. App. B, pp. A28-A29):

> Since the largest quantum of capital and labor respecting its [Moorman's] product sold here results from its Illinois relationship, the Iowa apportionment formula fails to reasonably apportion profits traceable to Illinois operations and taxes those activities occurring in Illinois.

In reversing, the Supreme Court of Iowa did not dispute the factual conclusion of the district court that Iowa was taxing Illinois capital and labor contributions to income. Nevertheless, it found that the Iowa single sales-factor formula (J.S. App. C, pp. A78-A79)

> is fairly calculated to assign to Iowa only that portion of the taxpayer's net income reasonably attributable to the trade or business done in Iowa since the taxing power exerted by this statute bears fiscal relation to the protection, opportunities and benefits given by the state.

The formulation by the Supreme Court of Iowa confuses the due process requirement of a nexus sufficient to support the exercise of a state's taxing power[8] (never in dispute here) with the due process requirement that the tax be "fairly apportioned to the commerce carried on within the State." *Ott* v. *Mississippi Valley Barge Line Co., supra,* 336 U.S. at 174. To satisfy the former is not necessarily to meet the latter.

Here, the fact that Iowa taxed 100% of Moorman's net income from Iowa sales even though Illinois manufacturing activities contributed substantially to the production of such income demonstrates beyond any doubt that Iowa's single sales factor apportionment formula arrogates Moorman's income to Iowa out of all proportion to its activities therein, and projects Iowa's taxing power beyond its borders.

6. While the Court has given states a reasonable latitude in the development of apportionment formulae, it should not give approval to Iowa's aberrant sales-factor formula. To do so, as this Court noted in *General Motors, supra,* 380 U.S. at 553, 556-557, "lends sanction to an apportionment formula seriously at variance with those prevailing in the vast majority of states." Conversely, disapproval of Iowa's unique scheme would consolidate the gains toward uniformity of apportionment formulae which *General Motors* materially promoted and would discourage an emerging trend toward parochial and protectionist state taxation of interstate commerce.

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[8] *See, Wisconsin* v. *J. C. Penney Co., supra.*

The use of a three-factor property, payroll and sales apportionment formula by forty-four of the forty-six states with corporate income taxes represents the culmination of a continuing movement toward use of the three-factor formula during this century. While there still are differences among the states in their definitions of "property," "payroll" and "sales," the use of the same three factors in their apportionment formulae is an important step toward complete uniformity of apportionment formulae and thus toward elimination of multiple taxation.

In 1929, the sixteen states with corporate income taxes used eleven different apportionment formulae, the most popular of which were a one-factor formula based on property and a one-factor formula based on sales. By 1953, fifteen formulae were in use, but sixteen of the thirty-five states with corporate income taxes employed the three-factor formula. Special Subcommittee on State Taxation of Interstate Commerce, House Committee on the Judiciary, *State Taxation of Interstate Commerce,* H.R. Rep. No. 1480, 88th Cong., 2d Sess. (Vol. 1) 119 (1964). The movement toward uniformity of factors was further aided by the adoption in 1957 by the National Conference of Commissioners on Uniform State Laws of the Uniform Division of Income for Tax Purposes Act (UDITPA), which provides in § 9 for a three-factor apportionment formula based on property, payroll and sales.[9]

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[9] The Multistate Tax Compact was adopted in response to the enactment by Congress of P.L. 86-272, 73 Stat. 555 (1959) (15 U.S.C. §§ 381-84), and the introduction of H.R. 11798, 89th Cong., 1st Sess. (1965), as the result of the Congressional study of state taxation of interstate commerce mandated by P.L. 86-272. The acknowledged purpose of the Compact was to preempt potential Congressional legislation dealing with protection of interstate commerce from discriminatory taxation. The Compact, whose constitutionality is now at issue in this Court in another appeal, copied UDITPA.

The Multistate Tax Commission created by the Compact has been inconsistent in its support of the equally weighted three-factor

In 1963, shortly before this Court's decision in *General Motors*, twenty-six of the thirty-eight states with corporate income taxes used the three-factor formula, and the number of different formulae in use had declined to eleven. *State Taxation of Interstate Commerce*, *supra*, at 119. As noted above, this Court's disapproval of the single sales-factor formula in *General Motors* in 1965 further accelerated that trend, so that today forty-four of the forty-six states taxing corporate income use the three-factor formula.

Iowa's single sales-factor apportionment formula is a glaring exception to this trend. However, beginning in 1971, four states which utilize three-factor apportionment formulae—Florida, Wisconsin, New York and Massachusetts—have moved in the direction of Iowa's discrimination against out-of-state businesses by attributing double weight to the sales factor of the apportionment formula, a practice which incorporates to a lesser degree the vice of Iowa's single sales-factor formula.[10] The Court's disapproval of Iowa's formula would discourage this emerging trend away from the generally accepted three-factor formula and thus would solidify the gains that have been made toward uniformity of apportionment and reduction in multiple taxation.

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formula required by UDITPA. For example, Florida, one of the seven founding members, was continued by the Commission as a full member of the Compact notwithstanding that state's adoption of a discriminatory double-weighted sales factor which violated the specific terms of the Compact. Moreover, the Multistate Tax Commission has promulgated regulations which obliterate key elements of UDITPA, particularly with respect to non-business income and the so-called unitary business-combined return concept.

[10] In addition, a bill providing for double weighting of the sales factor was introduced in the Illinois State Senate on April 7, 1977. The bill, S.B. 737, came up for a final vote by the Senate on May 26, 1977, but was recommitted to the Senate Revenue Committee for further study of its revenue impact.

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of Iowa should be reversed.

Respectfully submitted,

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